RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Feb. 11, 1998 **LETTER 1245**

WHICH WAY? In my opinion, the biggest and most important question for the market today is whether there's **inflation or deflation** in our future. The *Bank Credit Analyst* (February) writes, "A deterioration in trade will slow the pace of US economy growth to 2% or less for a few quarters. The Fed move will be to cut rates. The US equity market is not priced to this year's likely decline in earnings growth." And *13D Research* [(208)726- 1565] writes, "What is the most powerful secular trend in the world today? Our candidate is the global decline in inflation . . . If inflation rates surprise on the downside, so will interest rates . . . is it possible that the highest interest rates in capitalism (1980-81) will be followed by the lowest?"

This from the *Liscio Report* [(212)685-7231]: "Final domestic demand grew by 2.5% in the fourth quarter as real capital spending fell for the first time in seven years. Trade and inventories, big plusses in the fourth quarter, should be a big drag in the first quarter . . . IBM, MSFT, MER, PG, JPM, Corning, Polaroid, and Boeing are among companies blaming economic turmoil in Asia for weaker sales and profits . . . Unbridled growth is the last thing any economic entity has to worry about. As for the largest and most thriving economy, it's feeling the double edge of rising labor costs and escalating goods deflation. Unless you're an unabashed monetarist, it's difficult to see interest rates heading in any direction but south."

THE PICTURE: Question: Russell, what do you see here, or to put it another way, what do you think this market is doing?

Answer: The question really should be, "What are a lot of the world's markets doing?" And the answer is, "Going up." Last week the market averages of London, France, Spain and Italy hit new record highs while Germany was just short of its high. At the same time the S&P 500 recorded another new bull market high. Let me put it this way -- the desire (lust) for equities, as far as Europe and the US is concerned, has never been stronger.

Question: Are there any problems at all in the picture or have we moved into a state of market perfection?

Answer: Well, I've been watching Wall Street since the mid-'40s, and I've yet to see a state of market perfection. Wall Street, ornery animal that it is, always gives us something to worry about. For instance, at this point it's notable that daily new highs on the NYSE have dropped well below what we saw many months ago (for instance, in early October there were 600 new highs). That tells us that a great many stocks are not participating strongly in this advance.

Secondly, we're seeing a very rare instance of divergence between the D-J Industrial Average and the broader S&P 500 Composite. First, the **Dow** recorded its bull market high back on August 6, a full six months ago, and it has never been higher. In fact, as I've shown in charts over the last two Letters, the Dow has traced out a series of descending peaks.

But against this, the **S&P** has rallied to successive new highs. The first high occurred along with the Dow high back on August 6. That initial S&P high was 960.32. Next, we had an October 7 high of 983.12. Then a third high of 983.79 occurred on December 5. And most recently, on February 2, the S&P rallied to a new record high -- over the 1000 mark for the first time.

Jan. 30 DJIA 7906.50; PTI 5207; A-D Ratio +10.19
Feb. 6 DJIA 8189.49; PTI 5231; A-D Ratio +11.04
Dow Yield: 1.69%; Dow Price/Earnings: 21.7
Dow 144-day MA: 7761; Dow 34-day MA: 7918
Dow Times Book Value: 5.79; PTI 89-day MA: 5142
Percentage of Undervalued Blue-chips: 3%
Gold 34-day MA: 296

Question: What do you make of the surging S&P, particularly the fact that it has led the Dow for so many months?

Answer: What we have here is an extraordinary situation. A huge volume of speculative money is pouring into the **index funds,** and most of these funds are proxies for the S&P 500. As the index funds forge higher, the fund managers are forced to buy the stocks that underlie the S&P-index funds. Thus we have a true "upside feeding frenzy."

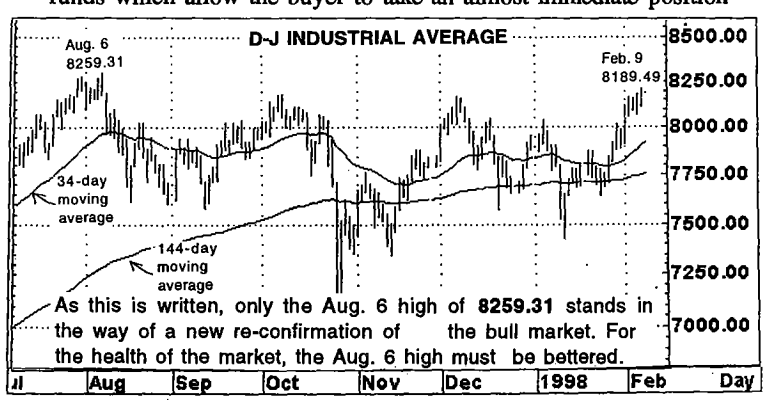
Question: Isn't this a potentially dangerous situation?

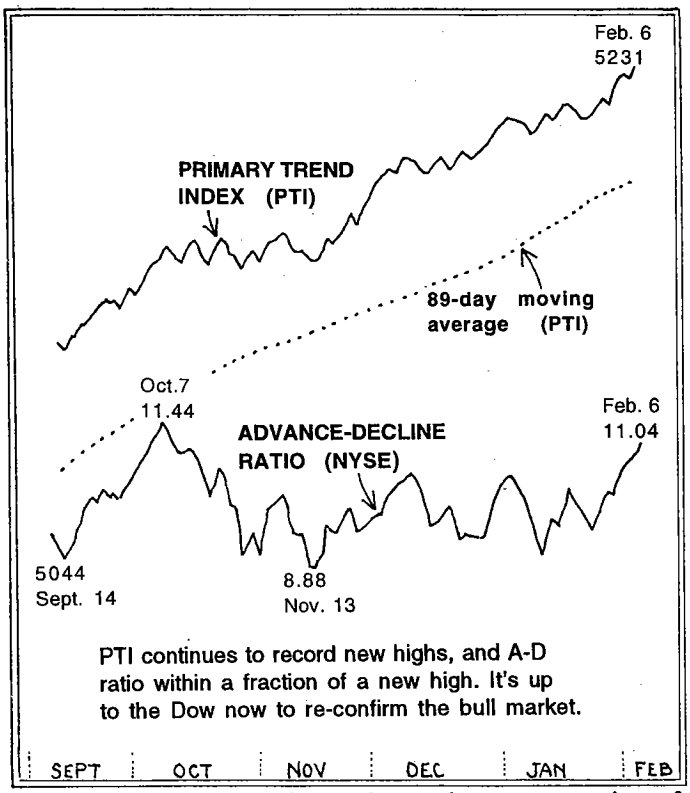
Answer: Well, it will be in due time. Every high-flying uncorrected market contains elements of danger -- but there's no way of telling when the "danger" will materialize. For years, subscribers have asked me, "Russell, how do you think this bull market will end?" And veteran subscribers know my answer has always been as follows: "This bull market will end the way all bull markets have ended. It will end **in exhaustion.** One day buying power will be exhausted, and the market will simply topple over -- it will fall of its own weight. When that will be -- what exact day that will occur -- nobody knows."

For example, why did the great bull market of 1921-29 topple over on September 3, 1929, and not on September 1 or September 5 or October 9th? Nobody knows; all we know is that the stock market reached the exhaustion point on September 3, 1929. Somewhere ahead the current bull market will reach its exhaustion point. And nobody, nobody on Wall Street or anywhere else, knows when that day will be. All we do know is that every 100 points higher on the Dow or the S&P is 100 points nearer the top.

Question: Are there any differences between this bull market and great bull markets of the past?

Answer: Human nature remains the same. At the extremes, market participants are governed, as they always have been, by two emotions -- greed and fear. Yet there really are two main differences between today's bull market and bull markets of the past. The first difference is the absolutely **massive participation by the public.** The second is the emergence of **index funds,** funds which allow the buyer to take an almost immediate position





in the market without having to buy a large cross-section of representative stocks.

Question: Russell, what do you think is behind the public's current "love affair" with equities?

Answer: Two phenomena. First, the fact that the bull market has been rising for so long without a costly, extended correction. This has fostered the "buy-on-every-dip" syndrome. The absence of a severe, extended correction has also given participants a feeling of safety and comfort. The longer the bull market goes on without a serious correction, the bolder and more confident the buyers and holders of stocks become.

The second phenomenon is that people have lost confidence in government and most certainly in the "promise" that in their old age they will be taken care of by Social Security. Americans have heard all those dire predictions of the death of Social Security and Medicare. Thus, they feel they now have to provide for their own futures. What better, they reason, than buying stocks that are on a perpetual "up escalator?"

Furthermore, who are today's heroes? They aren't our president or the leader of the House or the president of Harvard. No, they are the great monetary successes -- Warren Buffett (the world's most successful investor), Bill Gates (the world's richest man), Steven Spielberg (Hollywood's most successful movie-maker), George Soros (the US's most famous speculator), and Michael Jordan (our richest sport star).

The nation is in the psychological phase where "money is everything, and everything is money." It's a phase that has been seen many times before -- most recently during the 1920s. **That's the reality**, and we'd better accept it and deal with it. I'm not for a moment saying that I want my subscribers to embrace the prevailing "show me the money" state of mind. Be yourself, follow your own inner voice, go where your instincts tell you to go -- but understand that **making money** ("show me the money") is the sentiment of the times, and the stock market simply reflects this sentiment.

When the neophyte asked the ancient Chinese guru for a single phrase that would fit every situation in life, the guru pondered for a few minutes and then answered, "This too shall pass." So too will today's money mania pass -- but when it does, we may find that the new phase will be considerably less to our liking.

Reality: OK, now let's change the subject and discuss what the market is actually doing. And let's follow the rule of the hard-nosed floor trader -- "No hoping, no wishing, no praying, no opinion."

Question: We have new highs in the S&P but what do you make of the declining peaks in the Dow (see page 1 chart)?

Answer: The Dow 30 are the BIG blue-chips of the NYSE. Those 30 stocks make up probably 25% of the value of the entire NYSE. As such, the action of these 30 stocks cannot be ignored. No group of 30 stocks are more scrutinized, analyzed, mulled over and examined than the Dow 30.

Most of the D-J Industrial stocks do a good deal of exporting. My thinking is that this is the group that is most sensitive to what's happening in Asia, and maybe what's coming up in the economy. Let me put it this way -- the Dow hit a peak of **8259.31** back on August 6. Something's been bothering the Dow, at least up to now, because it's been such a consistent laggard. I don't know what's been bothering the Dow, and I really don't have to know. All I do know is that the action of the Dow since August 6 has been somewhat suspicious.

Maybe the Dow will advance to new record highs tomorrow or next week or next month. Maybe, but I have to deal with what's happened so far. And so far the Dow just hasn't confirmed either the S&P or the Transports. That sets up the market for at least potential trouble.

Question: OK, but you call your letters Dow Theory Letters so what does the Dow Theory say about all this?

Answer: Basically, here's what the Dow Theory says. **(1)** When the Averages (Industrials and Transports) are fluctuating in an area below their highs but above recent lows they're in the territory that I've always called "no man's land." Or to put it another way, the Averages are locked in a trading range.

(2) But here's an important consideration. **Under Dow Theory, a trend is taken to continue until PROVED otherwise.** The last time the bull trend was confirmed was on August 6. On that day **both** the Dow and the Transports hit record highs together. The Transports continued on, recording new highs, but the Dow has never advanced above its August 6 high of **8259.31.**

Nevertheless, August 6 did constitute a bullish re-confirmation of the primary bull trend. And nothing since August 6 has rescinded or countermanded the August 6 bullish re-confirmation. Thus, **under Dow Theory the trend remains bullish.** This may seem convoluted or even naive, but it is important.

Question: All right, under Dow Theory the primary trend remains bullish. But what would it take from here to signal a change in trend, a primary bear market?

Answer: For a bear market to be signaled, the two Averages would have to turn down and both Averages (Industrials and Transports) would have to violate their recent important lows. Those lows (both struck on October 27) are **7161.15** for Industrials and **3004.58** for the Transports. Clearly, both Averages are now far above the October 27 lows, so it would take a good deal of decline before a Dow Theory bear market could be signaled.

Question: Russell, what are some of the areas you are watching now?

Answer: Here are some important items that must now be taken into account. **(1)** The S&P has been hitting new highs, and that's an obvious plus (even though not confirmed by the Dow). **(2)** My Primary Trend Index (PTI) has been recording successive new

highs, and that's another obvious plus. **(3)** The advance-decline ratio has held well above its November 13 low of 8.88, and although its still below its October 7 high, it is trending higher, a good sign (see page 2 chart). **(4)** Bonds have behaved well, with the yield on the long T-bond holding below 6%. **(5)** Daily new highs are lagging, but they do continue to come in well above new lows. **(6)** The majority (daily basis) of the 15 most-active stocks on the NYSE continue to be heavily on the plus side. **(7)** The market continues to absorb bad news very well (for instance, the Clinton scandals have not really dented the market). **(8)** One problem -- on February 3, the D-J Transports closed at a new record high, again unconfirmed by the Dow. Each new non-confirmation puts **additional pressure on the Dow to confirm**, and, of course, a Dow confirmation entails the Dow rallying to a new high above **8259.31**.

PTI: A few words about my PTI. It almost seems as if the PTI is incapable of lapsing into a down-trend. In fact, I've had newer subscribers ask me whether there's something inherent in the construction of the PTI which gives it a powerful bullish bias. Veteran subscribers know differently. They saw the PTI top out on January 11, 1972, at 1051. By December 6, 1974, the PTI was down to 578, a loss of 473 points amid one of the worst collapses in stock market history. Again, for example, the PTI topped out on January 17, 1981, at 1510; by August 12, 1982, the PTI had fallen to 1296, a loss of 214 points, this while the Dow tumbled from 1024 to 776.

So yes, the PTI most definitely can go down, it can go down precipitously. But the fact is that for the past few years the PTI has either advanced -- or moved sideways and then advanced again. In other words, so far, the PTI has not shown any signs of weakness (instead of correcting, it simply moves sideways); amazing but that's the fact.

I've always told subscribers that the PTI is absurdly easy to read; all you have to know is up from down. As for interpretation, if the PTI is holding above its 89-day moving average it's in a bullish mode. If it's below its 89-day MA, it's in a bearish mode. I don't know anything simpler than that.

One more comment about the PTI. The PTI is based totally on **market action.** Thus, the PTI couldn't care less about yields, earnings, valuations, short interest, option-ratios, news events, history, Wall Street sentiment, your opinions or mine. The PTI is strictly a function of components that move the market. As such the PTI is a cold, remorseless indicator of market **direction.** Remember, the level of the PTI is not important, but the **direction** of the PTI is extremely important. And frankly, the PTI is the best indicator of market direction that I've ever seen or dealt with.

Question: Russell, you seem to be concerned with the Dow as opposed to other stock averages. Why?

Answer: There are many stock averages, but in my opinion the Dow is the locomotive that moves the market. The Dow is, as the California surfers might put it, the "big Kahuna." For this market to really break-out across-the-board on the upside, the Dow has to move up and move up strongly. I just don't see the stock market going very far on the upside or the downside without the participation and preferably the leadership of the Dow.

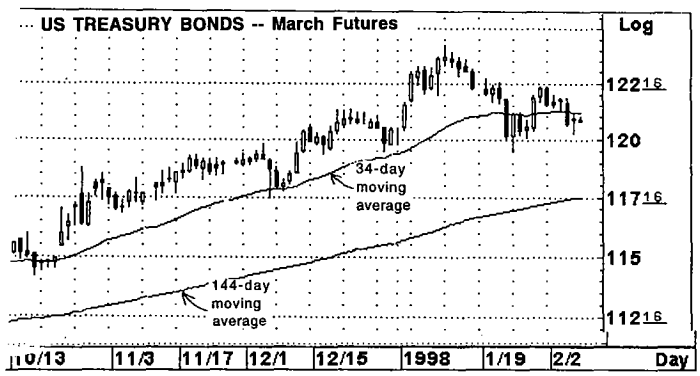
Therefore, it will pay us to watch the action of the Dow over the period ahead. We still have those successive declining Dow peaks. So let's just watch to see whether the Dow can hurdle its preceding peaks and, in due time, make its way back and above its August 6 bull market high.

To review the situation -- the first upside target for the Dow was the January 20 peak of 7873.12. On January 28 the Dow bettered 7873.12. This was a minor triumph. But the Dow still has two additional peaks to hurdle before we can receive an "all clear" signal.

The Dow has been plowing through overhead resistance, rallying above the January 5 peak, then above the December 5 peak (see page 1 chart). As this is written, only the October 7 peak of 8178.31 and the August 6 record high of 8259.31 stand in the way of a Dow Theory re-confirmation of the bull market. Will the bull market be re-confirmed? Why guess, let's just watch the action.

BONDS: The bond chart is well worth studying. At its previous high, the T-bond contract (March futures) rallied too far above its 34-day moving average. By the same token, the 34-day MA in turn got too far above the 144-day MA -- note the huge spread between the two MAs. The result -- an over-bought situation, and a nine-day correction. The correction took the bonds below their 34-day MA, but they held below the 34-day MA for only four days. On January 29 the bonds surged above their 34-day MA again. Since then, the bonds have been backing-and-filling just above their 34-day MA.

Newer subscribers please take note: when a correction lacks the power to drive the 34-day MA below the 144-day MA, this is a sign of continuing internal strength. Then, if the price turns around and rallies above the 34-day MA again, this constitutes a "buy signal." That's what occurred when the bonds on January 29 rallied above their 34-day MA (see chart). **Note:** a closing by the March T-bond futures above 122 9/32nds would be very bullish for bonds.



Question: We have the famous Super Bowl indicator, which now says that the bears will take over. We also have the January indicator which could be in favor of the bears. What do you think?

Answer: I think the Super Bowl indicator is pure superstition. Or let's call it a series of coincidences, but don't take it seriously. As for the January superstition which states that as January goes, so goes the year, forget about this one too. Ironically, the Dow was down 0.02% for the month of January while the S&P was up 1.01% for January. So take your choice -- even if you believe in the January indicator (which I don't) you can place your bets either way.

Question: OK, Russell, so what's your final conclusion after all the preceding verbiage?

Answer: I'm going to follow Dow Theory and my PTI. **Conclusion:** It's still a bull market. I will be watching the lagging Dow, but that's not enough to turn me bearish. Thus, the bull lives.

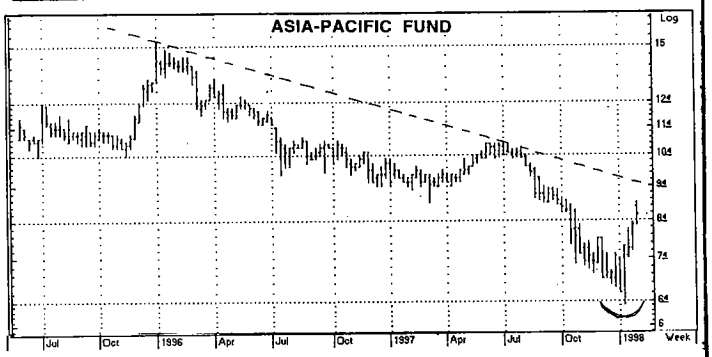
Finally, watch the PTI. If it continues climbing to new highs, it will be telling us that the basic forces under this market are bullish. **If** the PTI lapses into a downtrend, that will be a sign (particularly in view of the non-confirming Dow) that there could be trouble ahead.

INVESTMENT POSITION: With new record highs in the S&P 500 and the Dow within shooting distance of a new record high, the bull remains in the box, crowded a bit by a small question mark. The question market will be removed the day the Dow hits a new record high above 8259.31.

The higher this market pushes into the stratosphere, the more nervous I get. Personally, I've moved into T-bonds, T-notes, T-bills and cash. I'll just watch the fireworks from here; I'm not greedy, I'm not hysterical, and I'm not ready to pile into an index fund.

If there are any bargains around, they may exist in Asia. Morgan Stanley's Asia-Pacific Fund (APF), a closed end fund, was 15.25 at its '96 high, and last week it was trading around 8 1/2. It's an interesting play on the thesis that stock markets in Asia have seen their worst. This rundown of the Asia markets is worth studying (statistics courtesy of Growth Fund Research, Box 6600, Rapid City, SD 57709).

	High	% Decline	Low	% Rise To Date
China Free	1997	-67.1	1998	+ 9.2
Hong Kong	1997	-53.1	1998	+12.4
India	1994	-50.6	1996	+15.1
Indonesia	1994	-89.8	1998	+11.2
Japan	1989	-56.5	1992	+28.1
Korea	1994	-86.3	1997	+73.7
Malaysia	1994	-79.4	1998	+21.8
Pakistan	1994	-62.1	1997	+11.2
Philippines	1994	-73.3	1998	+15.6
Singapore	1996	-60.5	1998	+17.2
Thailand	1994	-91.9	1998	+40.3



NOTES & QUOTES: Pardon: I receive four to eight (often more) letters from subscribers every day. I read each letter carefully -- many of them contain interesting thoughts, data, comments, questions. But for the most part I can't answer all these letters. This is frustrating for me, but I have just so much energy and brain power, and I feel that I owe it to my subscribers to direct my energy to ALL of you via what I write in the Letters.

I get up at 3:15 every day, read five newspapers, get to my office at 6AM and by noon I'm "beat." I have lunch, take a half-hour nap, and then do a lot more reading (and hopefully, thinking) in the afternoon. I usually spend about half an hour on a Stairmaster around 3PM (which is boring so I play a tape in my VCR while pumping away). I eat dinner early, 4:30 PM -- early because I'm hungry and because I never feel good going to bed on a full stomach. My wife, Faye (a hard-working lawyer) gets home about 6:30, and she usually just has a snack. We hit the sack around 9PM, and that's the way it goes. Whatever extra energy I have usually is directed to seeing my kids or grand-kids or at least talking to them on the phone.

* *

The $18 billion bailout of East Asia, will it happen or won't it? Clinton wants it, Treasury Secretary Rubin wants it, Greenspan wants it. But will they get it? Congress has to OK the bailout, and many Congressmen of both parties are against it. Rubin suggested that if the US fails to back up the IMF in bailing out Asia, the negative effects could impact on Japan, Latin America, Europe and ultimately the US. But many objectors state that the bailout is basically bailing out US banks that made dangerous loans to various South Asian companies. Meanwhile, Greenspan warns that the mess in Asia will start to be felt by US businesses in the spring.

One plus for American companies in the Asia collapse is an opportunity, particularly for the US banks, to gain a major foothold in Asia. What the US banks can offer is cash. Moreover, the IMF and arm-twisting by the US may mean that US companies will gain entry to previously closed Asian markets. The other side of the coin is whether Asian resentment will build, based on the feeling that US companies have taken advantage of the problems of Asia.

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Russia, having knocked two zeros off the ruble, is in the process of defending the "new" ruble. Two weeks ago the yield on a Russian T-bill surged to 42% and some have called for a rise to 60%. In other words, it's kind of expensive to borrow rubles in Russia today.

In China, things are different. The big question is whether China will hold the value of the renminbi to 8.3 to the dollar. If China devalues, as it did by 33% in 1994, that would make its exports less costly than those of its Asian neighbors; in fact another Chinese devaluation would almost surely set off another set of competitive devaluations in Asia. Behind China's pledge not to devalue are $140 billion in foreign exchange reserves, second only to Japan's $228 billion (the US has $56 billion in reserves, Germany has $77 billion).

So actually China faces three decisions: **(1)** whether to devalue; **(2)** whether to draw on its huge foreign reserves in order to help out its Asian neighbors (so far, it has); and **(3)** whether to exercise diplomatic leadership that would boost China's campaign to dominate Asia and at the same time ease out the US.

So far China has been far ahead of the US in dealing with the Asian crisis. Also, ironically, the US failed to see the Asian crisis coming, mainly a failure of the press, academia and the so-called think tanks, the government in Washington, and the banks. The hints were there but nobody paid attention, although *Business Week* (Dec. 2) and the *Economist* did issue early warnings.

* *

The biggest lie (aside from Clinton's lies) is that the public is "fed up" with the media and its concentration on the latest Clinton scandal. Are they kidding? The public can't get enough of it. It's the biggest media bonanza since O. J., and not just in the US. Every foreign publication, magazine or newspaper, features the Monica story on its front page. London's *Economist* goes so far as to say that if Clinton even had sex with Monica he should go. Writes Meg Greenfield in *Newsweek*, "The worst outcome, I think -- the charges could remain unresolved, a kind of continuing, low-grade political infectious disease that just goes on and on and brings out the worst in everyone. Bill Clinton's loyal supporters, putting themselves at political and moral risk in his defense, are bound to be harmed if the situation just drags on, as are his party and his purposes." **Russell Comment:** Count on this -- Clinton and his crew will do what they always do -- stonewall, invoke "Executive Privilege," deny, lie, and hide evidence. Somehow, I doubt if it's going to work again. Then again, Monica might even decide to tell the truth, in which case it will be her word against Bill's. Who would you believe?

As far as the Clinton Budget, it's just more government, a long list of new spending and new taxes. Clinton told us that we're seeing, "The end of the era of big government." Right, and the era of really, really big government has arrived. As the *WSJ* put it on Feb. 3, "To the President's legacy list, add this: he has managed to capture more of the national income in taxes than any other President in peacetime American history." The fact: for the first time since WWII the government takes 20.1% of everything the nation earns. In 1999 the feds will swallow $1,742,700,000,000 in tax revenue (that's $1.7 trillion).

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Latest GOOD political news: in the latest polls Steve Forbes leads all other GOP candidates. Forbes is honest, intelligent and on the right side of most political issues (which means that I agree with him on most issues).

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People are still **spending** -- big time. Writer Tom Clancy and his group has just bid a cool $200 million to buy the Minnesota

Vikings football team. And last week an anonymous American at a Paris auction paid $950,000 for a Stradivarius violin. A second Stradivarius went for $716,000 at the same auction. Mr. Buffett laid out $850 million for one-fifth of the world's production of silver. And movie fans are spending for the movie, Titanic. According to *Variety,* the Big T looks as though it will be the first $1 billion movie (worldwide) in history. Jurassic Park holds the record so far with global sales of $913 million.

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The investment and participation in the stock market today is far beyond anything ever seen before in US history. According to a *NBC/Wall Street Journal* poll, 51% of adults say they own shares or mutual funds. Among registered US voters, shareholders outnumber those not in the market 53% to 43%. Writes the *NY Times* (Jan. 25), "This may be the least appreciated economic, cultural and political development of recent years. Over the last decade and a half, as the Dow was ascending from 80 to 8,000, luring tens of millions of middle-class Americans into the market, we have developed a mass culture of investing, the first to exist anywhere in the world. American democratic capitalism has brought about the democratization of capitalism." **Russell Comment:** There is now $3.4 trillion in equity mutual funds, $1.63 trillion in bond and income mutual funds. In December, investors put $16.8 billion in equity mutual funds alone. Total assets coming into all mutual funds during '97 was a record $231 billion as against $221 billion in '96. The amount of money pouring into mutual funds is unprecedented -- the world has never seen anything like it.

The *NY Times* article continues; "There's a simple explanation for the billions that continue to pour into the market despite widespread opinion that shares are overvalued. For the American middle-class, there is no real alternative to investing in stocks." **Russell Comment:** This is patent nonsense. Of course, there are alternatives to investing in stocks (assuming you can call buying stocks with yields at 1.6% "investing"). The alternatives are cash, bonds, bills, notes, munis, gold, gems, annuities, real estate and your own business.

* *

Asia may be having severe troubles, but then there's an island of happiness. On the northwest coast of Borneo sits **Brunei.** This little kingdom the size of Delaware has two blessings -- oil (160,000 barrels a day) and a small population of 300,000. This allows the Sultan of Brunei to offer his subjects cradle-to-grave security. Education, houses, health care, telephone services, all are free -- and there's no income tax. The big amusement park is free and food and utilities are subsidized. Low cost car loans are available. The retirement age in Brunei is 55, and no citizen need get a hernia from too much lifting, the heavy work is done by laborers from Thailand, the Philippines and India. Brunei's oil reserves will last another 15-20 years, its gas reserves maybe 50-60 years. In preparation for leaner times, the sultan has set up the Brunei Investment Agency with offices in London, NYC, and Tokyo. Its multi-billion portfolio is kept secret. Among prime real estate holdings are London's Dorchester Hotel and, in the US, the Beverly Hills Hotel. Brunei is not a democracy, but with everyone prospering, there's little or no complaining. But before heading for Brunei be careful -- it's hot.

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The public is told that stocks have provided average "appreciation" of 10% a year through the years since 1900. However, they are not told that half of this "total return" constitutes dividends. And with average dividends now down to an average 1.6% on the broad S&P 500 stocks, those who are buying stocks here have to be thinking in terms of appreciation rather than dividends return. But in the event of no appreciation, then today's buyers of stocks are loading up on securities that yield less than 2%, this in a market that has stalled out over the last six months. In other words, if this stock market continues to hold in a trading range, you'd be better off buying T-bills, T-notes or T-bonds. For today's stock or mutual fund buyer -- a rising stock market is a MUST.

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A subscriber writes to ask me how I can even mention deflation in view of rising prices in college tuition, air line fares, UPS and Federal Express charges, medical and dental bills, lawyer's fees, local phone charges, federal, state, and local taxes, cigarette prices, city bus and underground train ticket prices, minimum wages, insurance charges, cable rates, phone, electric and water bills, housing and hotel prices, bank ATM charges, hair-cut prices, and ticket prices to sports events. **My answer** is that almost all the price decreases have occurred in raw materials, commodities and many retail prices such as furs, computers, and the ever-present sales in which retailers offer "bargain" prices on selected goods. But as to real deflation in the economy itself, I don't see it. The government may claim that "there's no inflation," but those of us who pay the bills know differently.

I'll repeat again that there's a huge **disparity** between the income of today's rich and that of the average person. This shows itself in comparative prices: prices of luxury items have surged in recent months, whereas the consumer who shops carefully can find some bargains. The bargains, listed in the numerous sales, I guess, could be called a hint of deflation. On top of that, many manufacturers complain about the lack of pricing power. In other words, tough competition prohibits them from raising prices. That too, can be considered a kind of deflation. But real, classic deflation? That only happens when there isn't enough money around. And with the Fed's proclivity to create money out of thin air, the odds on classic deflation of the "Great Depression" kind are thin indeed.

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An increasing amount of information is coming out about Y2K, which is the problem that most PCs are not programmed to take care of the year 2000 (Macs are OK on this count). A 1997 survey of 6,000 companies worldwide found that 30% had not even begun to address the date-change problem. In the US itself, only about 520 companies have even mentioned Y2K in public disclosure filings as of the third quarter of '97. Late in '97 the SEC increased the pressure on companies to reveal what they had done in regards to Y2K. Companies failing to disclose Y2K costs will be required to explain themselves to the SEC. And the costs will be BIG. For instance, the cost to the government to convert its computers will be at least $4 billion. Chase Manhattan will spend $250 million. Fed Ex will spend $75 million. And so on down through the corporate chain. Small companies will spend billions on all-new computer hardware and software. Y2K -- it's a big deal, a huge expense, and the whole story is still far from out.

* *

Faye and I were at the Super Bowl, and this time it really was a Super Bowl. Nobody mentioned this, but we sat on the sunny side of the stadium and I mean it was HOT. It had to be even hotter on the playing field. I thought the heat got to the Packer line; by the end of the game they looked exhausted -- they were staggering. The Broncos, used to high altitude, looked tough and fresh. The Bronco offensive line was lighter and fared much better in the heat . . . Now NBC (frustrated by not having football in their future) is talking with Ted Turner of Time Warner about starting a football league of their own. They figure they can start a league of their own for $100 million. That's a lot cheaper than paying the NFL. But, Russell opinion -- forget it NBC, it's been tried twice before, it won't work.

* *

Another killing for Buffett? Some months ago Buffett bought $2 billion of long-term zero bonds, this when long rates were at 6.47%. The rumor now is that Buffett sold the zeros with a profit of over $450 million, and that he's placed the money in five-year T-notes yielding a bit over 5%. A shrewd move if true (and it probably is). Buffett made the most of a big surge in the bonds, then "de-leveraged" by selling the zeros, after which he bought the notes.

* *

"Figures don't lie, but liars can figure." There are two major lies flying around about US finances. The first is that there is now almost no deficit. The box on page 6 (courtesy of *USA Today*) tells us why there's "no deficit." The reason is that this year $91 billion was grabbed from Social Security receipts. If I snatched money from my employees pension plan and referred to that money as corporate income I'd be arrested.

The second item that no politician talks about is the still climbing national debt. Here's the picture (courtesy of the *Christian Science Monitor*). It keeps climbing. By the way, the interest on the national debt is now $250 billion. And additions to the national debt over the most recent 12 months were $173 billion.

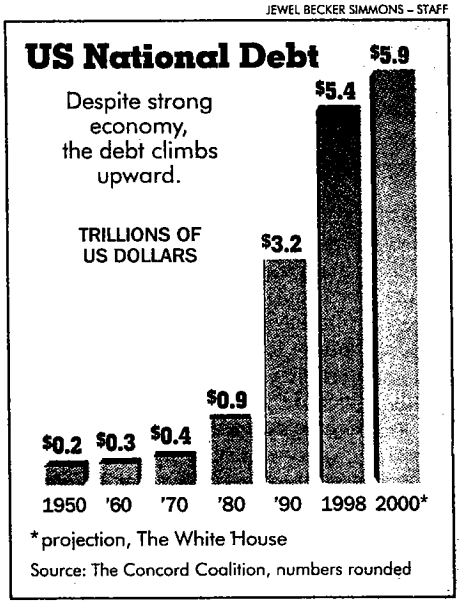
Hiding behind Social Security

When President Clinton, members of Congress and other policymakers talk about a balanced budget or federal surpluses, they don't mention the billions in taxes collected that are earmarked for Social Security. Here's the budget picture (estimated, in billions) when Social Security and other trust funds are removed from the equation.

	Budget surplus or deficit	Without Social Security
1997	-21.9	-103.3
1998	-10.0	-106.3
1999	9.5	-95.7
2000	8.5	-104.9
2001	28.2	-94.1
2002	89.7	-44.6
2003	82.8	-62.8

Source: Office of Management and Budget

JEWEL BECKER SIMMONS – STAFF



PRECIOUS METALS: The media has flooded us with news about Warren Buffett and his huge silver investment of 130 million ounces of silver (20% of one year's production). As a result, interest in silver has far overshadowed any interest in gold. Silver is a metal that is **consumed**, while gold is **saved**, hoarded, and it's probable that most of the gold ever mined in world history is still here -- in the form of coins, bullion (in various nations' reserves) and jewelry.

The silver picture is interesting. From its intra-day low of 4.68 (March futures) on October 28, silver last week rose to a high of 7.50, a spectacular advance of 60% in a period of less than four months. Not bad, but what's Buffett really thinking about? My guess: Buffett is a man who likes to buy at super-bargain prices; he is also known to hold onto an investment "forever." Buffett knew the supply/demand equation for silver was bullish, and he bought silver at bargain prices. Buffett knows the US money supply is surging, and he believes that somewhere ahead (six months, a year, five years) inflation will heat up again, at which time silver should move out. But most of all, Buffett believes he bought a wanted commodity at bargain prices.

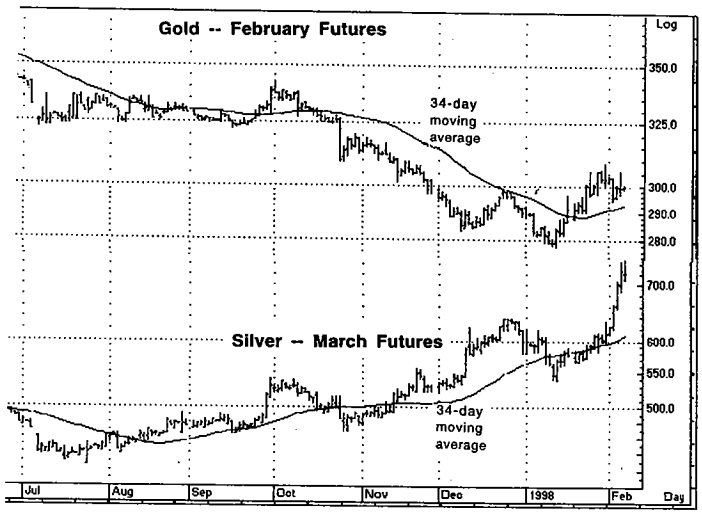
About gold -- from its extreme intra-day low of 277.5 (March futures) struck on January 13, gold rallied to a January 30 intra-day high of 308.9. That represents a rise of 11%. Gold, as this is written, has backed off but is still holding above its 34-day moving average (MA stands at 292). Question -- will surging silver impact on gold? Answer -- yes, to some extent. March gold closing above 306 would be very bullish for the metal -- but it hasn't happened yet.

What to do? I like Barrick Resources, Newmont Mines, and the Toronto pair -- Euro Nevada and Franco Nevada.

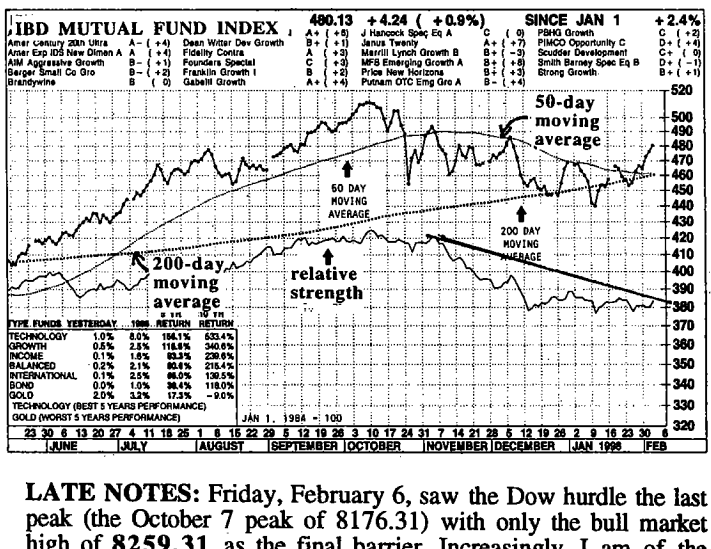
Item: When your currency goes down the drain there's always gold. A subscriber just sent me this little ad from the January 6 *Saigon Times Daily*. Here a house for sale, and what does he want for it? Gold.

NEXT MAILING: Feb. 25, 1998

Streetfront house for sale
Location : 327 Tran Hung Dao St., District 1, facing Southwest.
Price : 330 SJC gold taels
Size : 3m9 x 19m (extended at the back)
Ready for occupation, Private ownership, Main power and water supply.
Please contact :
Ms. Hoai Nho Tel : 8399827



INDEX FUNDS: Here's a fascinating phenomenon. "Sophisticated" investors think, "Why should I beat my brains out trying to pick the 'right' mutual fund when I can simply buy a S&P Index fund?" **Russell Opinion:** I think this is exactly what's happening, and it's bringing huge amounts of money into the index funds. Consider this -- the thousands of existing mutual funds constitute a proxy for the market itself. But when you deduct commission and management fees, there's no way that the great majority of mutual funds can keep up with the market. And the fact is that better than 75% of the funds are not keeping up with the S&P 500. Here's a chart of *Investor's Business Daily's Mutual Fund Index* (23 growth equity funds). Note the decline of the relative strength line, which means that the average of these leading funds is failing to keep up with the S&P. This trend will funnel an increasing amount of money into index funds, rather than mutual funds.


IBD MUTUAL FUND INDEX
480.13 +4.24 (+0.9%)
SINCE JAN 1 +2.4%
50-day moving average
50 DAY MOVING AVERAGE
200 DAY MOVING AVERAGE
200-day moving average
relative strength
TYPE FUNDS YESTERDAY 1998 RETURN 10 YR RETURN
TECHNOLOGY 1.0% 8.0% 194.1% 533.4%
GROWTH 0.5% 2.5% 116.8% 340.6%
INCOME 0.1% 1.6% 83.3% 230.6%
BALANCED 0.2% 2.1% 80.4% 215.4%
INTERNATIONAL 0.1% 2.5% 66.0% 130.5%
BOND 0.0% 1.0% 38.4% 118.0%
GOLD 2.0% 3.2% 17.3% -9.0%
TECHNOLOGY (BEST 5 YEARS PERFORMANCE)
GOLD (WORST 5 YEARS PERFORMANCE)
JAN 1, 1984 = 100
JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER JAN 1998 FEB

LATE NOTES: Friday, February 6, saw the Dow hurdle the last peak (the October 7 peak of 8176.31) with only the bull market high of **8259.31** as the final barrier. Increasingly, I am of the opinion that the money pouring into the S&P index funds is firing up this market, but let's not denigrate that phenomenon -- it IS happening and it IS pushing this market higher. An agonized bear (who's obviously short) called me on Friday and wailed, "How high can this market go?" I answered, "As high as needed to totally exhaust the buyers." That's a frustrating answer -- but it's the right answer and the only answer.